



COMPTROLLER

**UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-1100**

JAN 5 2001

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
UNDER SECRETARIES OF DEFENSE
DIRECTOR, DEFENSE RESEARCH AND ENGINEERING
ASSISTANT SECRETARIES OF DEFENSE
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
DIRECTOR, OPERATIONAL TEST AND EVALUATION
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

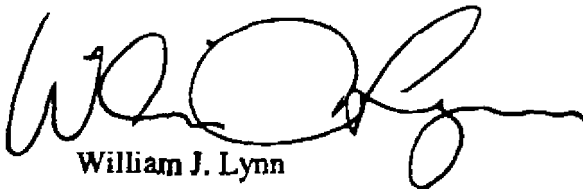
SUBJECT: Senior Financial Management Oversight Council (SFMOC) and Financial and Feeder Systems Compliance Process

Previously, the Defense Management Council approved the implementation of a process to oversee and monitor actions needed to ensure that the Department's critical accounting, finance, and feeder systems comply with federal financial management requirements. My memorandums of July 20 and October 13, 2000, circulated drafts of the proposed Financial and Feeder Systems Compliance Process to you for review and comment. Members of my staff have analyzed the comments and suggestions provided by your staffs and, as appropriate, have revised the Process.

The Process includes the designation of a senior level committee to provide oversight and guidance on system compliance issues. The Senior Financial Management Oversight Council (SFMOC) is being reconstituted to serve that vital function.

I hereby formally approve the SFMOC charter and the Financial and Feeder System Compliance Process for implementation within the Department. Attached are copies of both the documents, together with an addendum to the Process.

My staff contact is Mr. Gerald Thomas. He may be reached by e-mail: thomasg@osd.pentagon.mil or by telephone at (703) 604-6350, extension 125.


William J. Lynn

Attachments

ENCLOSURE (2)

CHARTER
SENIOR FINANCIAL MANAGEMENT OVERSIGHT COUNCIL

A. MISSION/PURPOSE

The Senior Financial Management Oversight Council (SFMOC) (hereinafter referred to as the Council) is established as the governing body for the Financial and Feeder Systems Compliance Process (the “Process”). The goal of the Process is to ensure that each critical financial management and feeder system, from single system and integrated systems perspectives, is compliant with applicable federal financial management requirements. The Process, patterned after the Department’s successful “Y2K” process, consists of the following five phases: awareness, evaluation, renovation, validation, and compliance. The Department desires that its critical financial and feeder systems be capable of providing requisite financial management and accounting information. The Council shall:

- a. Act as the final approval authority for all action plans developed during the *evaluation* phase.
- b. Provide oversight and guidance on all matters concerning the Process.
- c. Review the status of the applicable systems efforts on at least a quarterly basis.
- d. Approve the criteria for exit from each of the phases of the Process.
- e. Establish and oversee a Systems Compliance Working Group.
- f. Verify that all established exit criteria for a particular phase have been fulfilled.
- g. Perform such other tasks as may be appropriate to aid in the achievement of compliance with federal financial management system requirements.

B. MEMBERSHIP

1. Membership shall consist of the following officials:
 - a. Under Secretary of Defense (Comptroller) (Chair).
 - b. Principal Deputy Under Secretary of Defense (Comptroller) (Vice Chair).
 - c. Under Secretary of Defense (Acquisition, Technology and Logistics).
 - d. Under Secretary of Defense (Personnel and Readiness),
 - e. Assistant Secretary of Defense (Command, Control, Communications and Intelligence).

- f. Deputy Chief Financial Officer (Executive Secretary).
- g. Director, Defense Finance and Accounting Service.
- h. Director, Defense Logistics Agency.
- i. Assistant Secretaries of the Military Departments Financial Management and Comptroller).
- j. Assistant Secretary of the Army (Acquisition, Logistics and Technology).
- k. Assistant Secretary of the Navy (Research, Development and Acquisition).
- l. Assistant Secretary of the Air Force (Acquisition).
- m. Assistant Secretary of Defense for Special Operations and Low-Intensity Conflict.
- n. Deputy Chief of Staff for Installations and Logistics (Air Force).

The Inspector General, Department of Defense (DoD), in order to avoid conflicts of interest, will not be a member of the Council, but will serve as an advisor and may be requested by the Chair to provide support to the Council.

- 2. The chair may appoint additional members to the Council as appropriate.
- 3. Attendance at Council meetings will be by invitation of the Chair.
- 4. Representatives from other DoD Components and Government Departments and Agencies may be invited to participate in Council meetings at the discretion of the Chair.

C. RESPONSIBILITIES AND FUNCTIONS

- 1. The Under Secretary of Defense (Comptroller), as the Chair of the Council, shall:
 - a. Direct the operation of the Council.
 - b. Preside at Council meetings.
 - c. Approve the agenda for each meeting.
 - d. Determine the frequency of meetings.
 - e. Monitor the progress of the Process.

- f. Interpret, augment and promulgate financial management laws, regulations, policies and guidance within the Department in matters concerning the Process.
 - g. Provide periodic updates to the Defense Management Council.
 - h. Establish special committees, as determined appropriate by the Council.
- 2. The Deputy Chief Financial Officer, as the Executive Secretary of the Council, shall:
 - a. Identify issues to the Chair that require Council attention.
 - b. Schedule Council meetings.
 - c. Provide advance material to the Chair and members.
 - d. Ensure preparation of documents reflecting decisions by the Chair.
 - e. Followup and report on implementation of actions directed by the Chair.
 - f. Prepare and disseminate minutes for each Council meeting.
- 3. The Systems Compliance Working Group (SCWG) will be co-chaired by representatives from the Office of the Under Secretary of Defense (Comptroller) and the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics. Membership will include representatives from the offices represented on the Council. The SCWG shall:
 - a. Report to the Council.
 - b. Review all corrective action plans developed during the evaluation phase prior to submission to the Council and the Head of each DoD Component responsible for the system.
 - c. Coordinate actions pertaining to the compliance status of critical accounting, finance and feeder systems with the respective Components.
 - d. Review DoD Component quarterly system status briefings.
 - e. Recommend systems for exit from the phases of the Process.
 - f. Develop standard reporting formats for Component quarterly reporting to the SFMOC.
 - g. Develop a standard briefing format and instruct DoD Components to tailor their briefings to such format for consistency of presentation to the SFMOC.
 - h. Perform such other tasks as requested by the Council Chair.

DEPARTMENT OF DEFENSE FINANCIAL AND FEEDER SYSTEMS COMPLIANCE PROCESS

Introduction

The “Chief Financial Officers Act of 1990” requires that federal agencies implement integrated financial management systems. The “Federal Financial Management Improvement Act of 1996” mandates that agencies’ financial management systems comply substantially with: (1) federal financial systems requirements, (2) federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. Within the Department of Defense (DoD), these three mandates generally are referred to as federal financial management systems requirements.

As approved by the Defense Management Council (DMC), the Office of the Under Secretary of Defense (Comptroller) has developed the Financial and Feeder Systems Compliance Process (“the Process”). The Process, as described within this document, will be used to oversee and monitor the efforts of the Military Departments and Defense Agencies (i.e., the DoD Components) as they develop and modify critical finance, accounting, and feeder systems to comply with applicable requirements. The Process is patterned after the Department’s successful “Y2K process” and consists of five phases with defined exit criteria, which are addressed later in this document.

While the Process identifies specific procedures and exit criteria to be satisfied by the DoD Components, the Components’ execution of the Process must be done in concert with other DoD requirements and legislative mandates--particularly requirements levied and overseen by the Department’s Chief Information Officer. For example, the Components must address requirements stipulated in the Clinger-Cohen Act, to include business process reengineering (BPR) prior to and in concert with systems initiatives and efforts, and the consideration of outsourcing to satisfy mission needs.

For the Process to be successful, participation by senior leaders and the application of adequate resources are essential. Consequently, the Process includes the designation of a governing body to provide oversight and guidance to the DoD Components on systems compliance issues.

Goal of the Financial and Feeder Systems Compliance Process

The goal of the Process is to ensure that all critical accounting, finance, and feeder systems--both from single-system and integrated systems perspectives--are compliant with applicable federal financial management systems requirements. An integrated financial management system, as defined in Office of Management and Budget (OMB) Circular A-127, means a “unified set of financial systems and the financial portions of mixed systems (i.e., “feeder systems”) encompassing the software, hardware, processes, procedures, controls and data necessary to carry out agency financial management functions, manage financial

operations, and report financial status to the central agencies” (OMB and the Department of the Treasury). In turn, such compliance will enhance the capabilities of the systems (individually and collectively) to provide timely and accurate financial data to senior DoD managers, aid decision making within the Department and help achieve favorable audit opinions on the Department’s financial statements.

For the purpose of this Process, a critical financial management system is defined as one which provides information that is materially important to entity -wide financial management, financial control, and financial reporting. (The Department’s financial reporting entities are listed later in this document.) Criticality is based on the concept that a system provides information which is important in: (1) producing reliable financial reports or statements; (2) ensuring that the Department’s missions are met within the financial parameters and constraints imposed by the Congress; or (3) assisting decision makers, including the Congress. Since ascertaining the criticality of a system is somewhat judgmental, the Process references materiality guidance that typically is used by federal auditors. This guidance helps establish a more finite basis for the Components to use in quantifying the criticality of their systems.

For example, federal auditors generally plan their audits of entities’ financial statements by establishing an overall dollar amount of accounts or financial statement line items to be audited. The dollar amount usually is based on a certain percentage of a “materiality base,” such as total entity assets or program costs. Available audit planning guidance indicates that the auditors customarily use 3 percent of the “materiality base.” To illustrate, if the entity’s total assets are valued at \$6 billion, then the auditors would plan to audit all financial statement lines (and supporting accounts) that are at least \$180 million (3 percent of \$6 billion).

To achieve consistency throughout the Department, the Components/reporting entities--in ascertaining the criticality of their financial and feeder systems--shall use an approach that mirrors the one identified in the previous paragraph. In this regard, the Components--in order to ascertain those systems deemed to be considered critical and, therefore, subject to this Process--shall analyze the source of financial data for all financial statement line items that are greater than, or equal to, 3 percent of total reporting entity assets (since the DoD Components/reporting entities, overall, are capital asset-intensive entities). For any financial statement line item that has a balance greater than, or equal to, 3 percent of total entity assets, the reporting entity shall deem critical any system that is the source of values equal to, or greater than, 10 percent of the total amount reported on the applicable financial statement line.

To illustrate the application of this guidance and using the amounts cited above, a reporting entity would consider critical any system that provides \$18 million in values/balances to any financial statement line item that totaled \$180 million. It should be noted that this application applies to all of a reporting entity’s principal financial statements (such as the statement of net cost or statement of budgetary resources), not just its balance sheet.

Roles and Responsibilities

The DoD Components are responsible for ensuring that their financial and feeder systems comply with applicable federal and DoD financial management requirements. The Defense Finance and Accounting Service (DFAS) owns and operates most of the Department's accounting and finance systems and, therefore, is responsible for ensuring that those systems comply with applicable requirements. Several DoD Components own and operate mixed systems, and some also operate their own accounting systems. As with the DFAS, those Components are responsible for ensuring that their systems comply with pertinent requirements.

Additionally, some DoD Components own and operate critical feeder systems that provide significant amounts of data to the DFAS systems. In those instances, the applicable DoD Components are responsible for ensuring that their systems comply with pertinent requirements. In certain instances, multiple Components may use a single feeder system. For those systems, the requisite functional office within the Office of the Secretary of Defense (OSD) is responsible for ensuring that the Components satisfactorily resolve any compliance problems. For example, the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics (OUSD(AT&L)) is responsible for ensuring that those DoD Components that use the Standard Procurement System, the Joint Ammunition Standard System, or the Defense Property Accountability System appropriately address and resolve financial management compliance issues. The Components (whether singular or joint owners)--with consultative guidance and assistance from the DFAS--are responsible for ensuring that their feeder systems comply with applicable requirements. The DFAS and the other Components jointly are responsible for ensuring the efficient and effective interaction of their feeder systems with the DFAS accounting and finance systems.

The oversight body for the Process will be the Senior Financial Management Oversight Council (SFMOC), which has been restructured accordingly to manage this Process. Meetings of the SFMOC shall be held periodically at the call of the chairman, but generally no less frequently than quarterly. The SFMOC shall provide oversight and guidance to the DoD components in all matters related to the Process. A Systems Compliance Working Group (SCWG) also will be formed and will be subordinate to the SFMOC. The DoD Components that own a critical financial or feeder system or the requisite functional office within the Office of the Secretary of Defense (as described in the preceding paragraph) shall be responsible for satisfying the exit criteria for each phase of the Process.

Composition and roles and responsibilities of the SFMOC and the Systems Compliance Working Group are addressed in the SFMOC Charter (copy attached).

- Office of the Under Secretary of Defense (Comptroller) (OUSD(C)). The OUSD(C) shall.
 - Monitor the progress of systems subject to the Process
 - Chair meetings of the SFMOC and co-chair (with a representative of the OUSD(AT&L) meetings of the SCWG

- Review and interpret federal financial management statutory and regulatory requirements and provide DoD policy and guidance in matters concerning the Process
- Report periodically to the Defense Management Council on matters related to financial management systems compliance.
- DoD Components. Each DoD Component shall :
 - Implement, in conjunction and cooperation with the DFAS, the five phases of the Process for all critical accounting, finance and feeder systems identified in the Department's annual "Financial Management Improvement Plan"
 - "Map" the flow of financial transactional information from points of origin to reporting in the various line items on the pertinent annual financial statements
 - Implement corrective action plans and compliance recommendations approved by the SFMOC for critical accounting, finance and feeder systems
 - Complete, in conjunction with the DFAS, an evaluation of each of the Component's critical accounting, finance and feeder systems
 - Report results of each evaluation to the OUSD(C)
 - Report to the SFMOC the summarized results of each phase of the Process for each system, including missed milestones, schedule slippages and related adjustments
 - Provide briefings to the SCWG and the SFMOC on the status of the Component's systems that, since the last briefing, have fulfilled all exit criteria for a particular phase or are encountering difficulties during a phase, e.g., missed milestones or schedule slippage
 - Submit for approval to the Head of the DoD Component or the Component Head's designee, all corrective action plans and corresponding funding plans. For purposes of the Process, the Secretary of a Military Department may designate officially an executive to fulfill required Component approval functions. The designee, however, shall be at an executive level equal to or above the functional "appointee level" (such as an Assistant Secretary (Financial Management and Comptroller)
 - Submit, through the SCWG to the SFMOC, for review and SFMOC approval, Component-approved corrective action plans for all systems
 - Ensure that program managers maintain adequate compliance documentation for each system
 - Update the Process database on a monthly basis and report any significant upgrades, changes or revisions to the SCWG.

In addition, each DoD Component shall identify an appropriate official to oversee implementation of the Process within that Component.

- Office of the Inspector General, Department of Defense (OIG,DoD): The OIG,DoD, in order to avoid conflicts of interest, will not be a member of the SFMOC but will serve as

an advisor. The Council Chair also may request the OIG, DoD to provide support to the SFMOC.

Phases and Exit Criteria

The Process is designed to achieve compliance individually for each critical accounting, finance, and feeder system. Additionally, the Process includes validation requirements to ensure that compliance also is achieved from an integrated systems aspect within each business area or process, such as inventory management, property management of acquisition management, as well as overall for the DoD reporting entity.

The Department's financial reporting entities are Component organizations or funds that, either legislatively or administratively, are required to prepare annual financial statements. Following are the DoD reporting entities for fiscal year 2000:

Required by OMB

- Department of Defense (consolidated)
- Army General Funds
- Navy General Funds
- Air Force General Funds
- Army Working Capital Funds
- Navy Working Capital Funds
- Air Force Working Capital Funds
- Military Retirement Fund
- United States Army Corps of Engineers (Civil Works).

Required by DoD

- Ballistic Missile Defense Organization (BMDO)
- Defense Advanced Research Projects Agency (DARPA)
- Defense Commissary Agency (DeCA)
- Defense Contract Audit Agency (DCAA)
- Defense Finance and Accounting Service (DFAS)
- Defense Information Systems Agency (DISA)
- Defense Logistics Agency (DLA)
- Defense Security Service (DSS)
- Defense Threat Reduction Agency (DTRA).

Compliance by business area and reporting entity is discussed further in the Compliance Phase.

The Process is designed to ensure that all critical finance, accounting and feeder systems meet standard exit criteria before advancing from one phase to the next. The DoD Components shall execute the five phases of the Process for each of their respective critical accounting, finance and feeder systems. The DFAS, with support from the other DoD Components, has overall responsibility for "end-to-end testing" of the integrated systems by business area and reporting entity.

Some of the DoD Components previously have been working to address deficiencies in their critical financial and feeder systems. Those Components may have developed “compliance processes” to oversee and manage their systems enhancement efforts. The implementation of this DoD-wide Process is not intended to require duplicative efforts and or the replication of actions taken to date. The Components, however, must assure the SFMOC that their efforts to date on each critical system satisfy the exit criteria of the applicable phase to which they have progressed. For example, if a DoD Component currently is implementing corrective actions under its “process,” then that Component must verify to the SFMOC that such actions, once completed, satisfy the exit criteria for the Awareness, Evaluation, and Renovation Phases for the DoD-wide Process.

The OIG, DoD --in its advisory role to the SFMOC and SCWG --will lead the audit community, including private sector firms contracted to conduct validation audits, in applying consistent and comprehensive coverage for each system at the Validation Phase. Results of validation audits will be reported through normal reporting channels, but also will be summarized by the OIG, DoD for presentation to the SCWG and SFMOC. Each DoD Component shall work with its auditors to plan appropriate validation support during the other phases of the Process (similar to the support provided during DoD’s “Y2K” effort).

Details regarding the five phases of the Process and their exit criteria follow.

Phase 1: Awareness Phase

Senior leadership involvement is the key to the Awareness Phase. The primary purpose of the Awareness Phase is to promote acknowledgement of, and participation in, the Process across the entire Department. This phase includes the identification of all DoD Component accounting, finance, and feeder systems, followed by a determination of those systems that are “critical” to each Component’s financial management, financial control, and financial reporting. Those systems then become the Component’s “suite” of critical accounting, finance, and feeder systems.

Each reporting entity should map the flow of its financial information from point of original entry to eventual reporting in annual financial statements. Such data mapping or transactional flow analysis should help ensure that the reporting entity has appropriately identified and considered the sources of financial information and their impact on overall data veracity.

Exit Criteria:

- (a) Identify and prioritize all critical accounting, finance, and feeder systems (for each Component).
- (b) Categorize each system according to its financial or financially related functionality (such as general ledger, property accounting, or inventory accounting). In this regard, the DFAS publishes “A Guide to Federal Requirements for Financial Management Systems” (“the Guide”) that contains requirements, by functional area, for financial and feeder systems. The Guide can be used by DoD Components to categorize their systems by function. It also contains selected DoD systems requirements, including the Standard

Fiscal Code (SFC), developed by the DFAS for Department-wide use in recording, processing, classifying, and reporting financial transactions in financial and feeder systems.

- (c) Identify required interfaces for all of the Component's critical feeder systems and the DFAS core accounting and finance systems as well as other systems that originate financial transaction data.
- (d) Identify system owners and points of contact.
- (e) Define, based on "corporate" knowledge, previous audit reports or other viable sources, the overall compliance problem(s) --both from individual system and integrated systems perspectives. For example, an inventory system may not capture, control, and summarize all required transactions (an "individual system" problem) and also may not be linked electronically to the appropriate DFAS core accounting system(s) (i.e., an integrated systems deficiency).
- (f) Agree to correct the compliance problem(s).
- (g) Develop a strategic compliance strategy (i.e., correct system deficiencies, eliminate the system, consolidate the system with another, replace with another system, or employ a new system).
- (h) Obtain approval for the strategic compliance strategy from the Component Head (or designee) and the SFMOC.
- (i) Provide an estimate of resources (e.g., funding and personnel) for the Evaluation Phase of the compliance process.

Critical systems identified for elimination, scheduled for elimination, or awaiting consolidation prior to the end of fiscal year (FY) 2003 should be listed in the Awareness Phase regardless of their compliance status. Those systems that will remain in operation past the end of FY 2003 shall be subject to the Process until they actually are eliminated or their functions are consolidated into another system(s). Managers of systems that are to be eliminated should report the date that the system is scheduled to be eliminated, consolidated, or replaced.

Phase 2: Evaluation Phase

The Evaluation Phase addresses those areas required to define the size and scope of the compliance problem(s), decide the appropriate strategies to overcome the problem(s), and establish a plan to apply the necessary resources against the right tasks to make critical systems compliant. Program managers shall evaluate the current status of critical accounting, finance, and feeder systems and identify specific internal control weaknesses and noncompliance with accounting standards and federal financial management requirements for each system. Once a system has been evaluated, the cognizant program manager shall develop a corrective action plan for the system that identifies resources and milestones necessary to make the system compliant.

Exit Criteria:

- (a) Identify applicable compliance requirements by chapter from the most current edition of the Guide. That reference (as updated) includes specific federal financial management

systems requirements from the: “Federal Financial Management Improvement Act of 1996;” OMB Circular A-127, “Financial Management Systems;” OMB Circular A-130, “Management of Federal Information Resources;” OMB Bulletin 98-08, “Audits of Federal Financial Statements;” Joint Financial Management Improvement Program (JFMIP) Federal Financial Management Systems Requirements; “Statements of Federal Financial Accounting Standards” (SFFAS); and the United States Government Standard General Ledger. (NOTE: An addendum to this attachment offers more details on the requirements for compliance and the use of the Guide in determining compliance.)

- (b) Determine all system deficiencies using the Guide compliance factors. Such deficiencies should include problems in interfacing required data between the DoD Component’s feeder systems or between the Component’s feeder systems and the related DFAS core accounting and finance systems.
- (c) In cooperation with the DFAS, develop a corrective action plan to correct each applicable deficiency based on the compliance factors in the Guide. The corrective action plan shall identify required resources, appropriate milestones, and the responsible official(s).
- (d) For each corrective action plan developed, prepare a corresponding funding plan detailing the estimated costs to execute the corrective actions and the availability and sources of required funds.
- (e) Obtain approval of the system corrective action plan from the Head of the Component (or designee) before submitting the action plan through the SCWG to the SFMOC for approval.
- (f) Once the corrective action plan is approved by the SFMOC, obtain approval of the corresponding funding plan from the Head of the DoD Component (or designee) responsible for the system.
- (g) Provide a copy of all approved action plans and corresponding funding plans to the SFMOC, through the SCWG.
- (h) Establish Memoranda of Agreement (MOAs) between feeder system owners and the DFAS that specify responsibilities for correcting deficiencies, including interfaces between systems.

Phase 3: Renovation Phase

The purpose of the Renovation Phase is to implement the corrective action plans necessary to bring noncompliant systems into compliance with applicable requirements and conduct reviews of the implemented corrective actions. The extent of the activities carried out during this phase will likely vary for each system or group of systems (from an integrated systems perspective) depending upon the scope and magnitude of the problems identified in the Evaluation Phase. While this Process addresses compliance of critical financial and feeder systems, the Components must consider and take into account the impact of data “fed” by noncritical systems to the critical systems. The Components should “map” the source and flow of data into their identified critical systems in order to assess the impact of noncritical systems.

Exit Criteria:

- (a) Implement corrective action plans developed in the Evaluation Phase.
- (b) In conjunction with the DFAS, conduct reviews of each implemented corrective action and “end-to-end tests” of each individual system and group of related (interfacing) systems.
- (c) Verify, through the SCWG to the SFMOC, that the implemented corrective actions resolved all identified deficiencies.
- (d) The DoD Component that owns the system(s) shall certify that the system(s) complies with all identified requirements based on the latest edition of the Guide.
- (e) The SFMOC, after receiving certification that all corrective actions applicable to a system have been implemented, will request the OIG,DoD to validate the certification. Validation reviews may be conducted by the Military Department audit agencies, public accounting firms or independent consulting firms.

Phase 4: Validation Phase

The purpose of the Validation Phase is to ensure that all system problems have been remedied and that the system is compliant from an integrated point of view. Validations, in the form of audits or acceptable reviews, will be conducted by the OIG,DoD; independent public accounting or consulting firms; or Military Department audit agencies using a standard methodology promulgated by the OIG,DoD. The results of the audits/reviews will be presented through normal reporting procedures, to the OIG,DoD, for analysis and summarized reporting to the SCWG and the SFMOC.

The audit organizations and private sector firms (when utilized), will use the joint audit guide developed by the OIG,DoD to “validate” that any system reviewed at the request of the SCWG, which was certified “compliant” by the cognizant DoD Component, complies with specific criteria identified in the certification. The auditors will provide a report to the DoD Component and the OIG,DoD with their audit conclusions. This report will serve as documentary evidence of the independent validation. The report will clearly identify the validation tests/procedures used by the auditors, the criteria used, the scope of the audit, and the audit conclusions. Based on the results of a validation audit, a system may “move” to the Compliance phase of the Process, remain in the Validation Phase, or revert to a previous phase. The auditors, in conducting a system validation, will not consider a completed checklist as adequate documentation that a system complies with applicable requirements and, therefore, is “certified compliant.” Documentation must be retained to show how management reached the conclusion that the system being validated satisfied applicable requirements. In addition, the system manager must document test results and retain such documentation for subsequent review and analysis.

If major deficiencies are identified during the Validation Phase, the cognizant system manager shall return the system to the Evaluation Phase and provide additional corrective action plans to

resolve the deficiencies. If deficiencies are minor, and the SFMOC approves, the system may remain in the Validation Phase while corrections are being made and validated.

Before a public accounting firm or independent consulting firm is engaged to perform a validation audit, the DoD Component must comply with the provision in DoD Directive 7600.2 regarding approval by the OIG, DoD.

Exit Criteria:

- (a) Obtain validation from the OIG, DoD, a public accounting or consulting firm, or the respective Military Department audit agency (with OIG, DoD concurrence) that the system complies with applicable requirements. (NOTE: The compliance factors in the Guide shall be the basis for determining compliance.) The resulting validation report issued by any of these organizations will be considered documentation that the auditors have “validated” the Component’s certification regarding system(s) compliance with applicable requirements.
- (b) Provide documentary evidence of validation (i.e., audit/validation report) through the SCWG to the SFMOC.

Phase 5: Compliance Phase

The purpose of the Compliance Phase is to ensure that required documentation is available and maintained for those systems, business areas, and reporting entities that have been determined to be compliant by the OIG, DoD, a public accounting or consulting firm, or a military Department audit agency. The system manager, the business area manager, or personnel directed by the DoD Component’s senior leadership shall maintain all compliance documentation. That documentation shall be made available for use during system testing and validation.

Business Area and Reporting Entity Validations

The Department’s financial and financially related systems (e.g., property accounting, inventory accounting, and personnel systems) often provide information to multiple business areas and reporting entities that are supported by multiple systems. For example, a property system, such as the Defense Property Accountability System, may report information to business areas in the Army General Fund, the Army Working Capital Fund, the Navy General Fund, and the Navy Working Capital Fund. Each of these funds may be supported by several systems for which detailed transactions must be traceable from the balances recorded in the general ledgers to their source in the accounting, finance, or feeder systems.

These systems shall include appropriate internal controls in order for management to obtain accurate dollar values for property. Therefore, the overall systems supporting a business area or reporting entity cannot be compliant for property unless all of the systems supporting that function operate together as a compliant unit. Compliance of the integrated systems at the business area or reporting entity level cannot be determined, however, until all of the systems composing that business area or reporting entity are compliant. Therefore, “end-to-end”

integrated financial management systems tests shall be conducted following validation that all systems for a business area and reporting entity are compliant. Such tests are to be conducted as part of the five phases of the Process. The end-to-end integrated test is conducted with the associated accounting, finance, and feeder systems working in concert with each other. The test should be performed on a business area or reporting entity basis once all accounting, finance, and feeder systems for that business area or entity have been validated as compliant. The overall purpose of the end-to-end test is to ensure, from a business area or reporting entity perspective, that the entity's core accounting system and various finance and feeder systems operate in a compliant, integrated manner.

The DFAS, with assistance from the other DoD Components, shall be responsible for initiating and overseeing the business area and reporting entity validations. If deficiencies are found during the tests, the system(s) causing the deficiency shall be identified and then must reenter the Process at the Evaluation Phase. As a part of the Compliance Phase, the DFAS shall maintain documentation that supports the business area and reporting entity validations. The DFAS and the other Components, prior to conducting "end-to-end" testing of a business area or reporting entity systems, shall request auditors to observe the tests. Upon certification that the integrated financial management system (i.e., a "unified set of systems") for a business area or reporting entity is compliant, the DFAS will request the OIG, DoD to review the documentation which certifies that the end-to-end tests were successful.

New Systems Under Development

Federal financial management requirements and the Process identified herein apply equally to new systems under development as well as to systems being renovated. When a compliance strategy is developed to construct a new system, that system shall move into the Evaluation Phase where the requirements shall be defined. After the requirements are defined and development begins, the system shall move into the Renovation Phase. Upon completing development, the system shall move from the Renovation Phase to the Validation Phase and, after the system has been successfully tested in the Validation Phase, it shall move to the Compliance Phase.

Commercial Off the Shelf (COTS) Software

The JFMIP Program Management Office tests core accounting software and publishes a list of software that has been tested as compliant. JFMIP-approved software, provided it is not modified, may be placed in the Compliance Phase. Any core accounting software purchased based on the JFMIP testing that subsequently is modified, or any software purchased that is not JFMIP-approved, shall follow the process identified in the section above on "New Systems Under Development."

ADDENDUM TO FINANCIAL AND FEEDER SYSTEMS COMPLIANCE PROCESS

GOAL

The goal of the Financial and Feeder Systems Compliance Process is to ensure that each critical financial and feeder system--both from single-system and integrated systems perspectives--complies with applicable federal financial management requirements. This end state will enhance the ability of the Department's senior managers to obtain timely and accurate financial data which, in turn, will aid decision making and help assure the auditability of the Department's financial statements.

BACKGROUND

Over the past decade, the General Accounting Office (GAO) and the Department of Defense (DoD) audit organizations have issued numerous reports that criticized the Department's financial management systems and feeder systems for their inability to capture, maintain, control and report reliable, timely, and consistent information. Over the past several years, the Department has mounted a major effort to improve its financial management processes and systems. DoD leaders concluded that the Department's financial management deficiencies were more fundamental and entrenched than previously recognized. The desired remedy has resulted in the most comprehensive reform of financial management systems and practices in DoD history.

A major element of the Department's reform initiatives is the consolidation and standardization of finance and accounting systems. The first step was to designate certain existing finance and accounting systems as Migratory systems, into which the functions of similar systems (e.g., civilian pay, military pay and travel) would be consolidated. Simultaneously, the Department undertook improvements to its accounting systems to make them compliant with generally accepted accounting principles for federal agencies (issued by the Federal Accounting Standards Advisory Board (FASAB)). The objective of these improvement efforts is to make DoD accounting systems capable of providing accurate, timely, and auditable information to management and decisionmakers, including the Congress.

In order for the Department's accounting systems to produce accurate and auditable information, many systems--in addition to the accounting systems--need to be enhanced. Within the Department, dozens of systems provide financial data to the accounting systems operated by the Defense Finance and Accounting Service (DFAS). Much of these data which flow through a myriad of feeder systems, are not under adequate general ledger control and do not comply with federal requirements, thereby rendering the resulting financial information unreliable and unauditable.

The “Federal Financial Management Improvement Act of 1996” (FFMIA) and Office of Management and Budget (OMB) issuances provide specific criteria and requirements for federal financial management systems. Following are synopses of the FFMIA and the OMB guidance that materially impact the Department’s financial management systems.

“Federal Financial Management Improvement Act of 1996.” This Act requires each federal agency to implement and maintain financial management systems that comply with applicable accounting requirements and standards. Specifically, agencies’ financial management systems are to comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger (USGSGL).

OMB Guidance. The OMB formulates and coordinates management procedures and program objectives among federal departments and agencies. Relative to financial management operations and systems, the OMB adopts and publishes federal accounting standards that have been recommended by the FASAB, the Department of the Treasury, or the GAO. Also, the OMB has issued circulars and bulletins that establish requirements with which federal agencies must comply. Principal among these are Circulars A-127 and A-130, and Bulletin 98-08.

- OMB Circular A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems, including feeder systems.
- OMB Circular A-130 prescribes policies regarding information resource management.
- OM3 Bulletin 98-08 defines the minimum requirements for audits of federal agencies’ financial statements.

OMB Circular A-127 requires that all financial management systems and feeder systems comply with the following 12 factors.

- Agency-wide Financial Information Classification Structure. The system includes an agency-wide financial information classification structure that is consistent with the USGSGL, provides for tracking of specific program expenditures, and covers financial and financially-related information.
- Integrated Financial Management Systems. The system provides effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. Integrated Financial Management Systems are required to have the following characteristics:
 - Common Data Elements
 - Common Transaction Processing
 - Consistent Internal Controls
 - Efficient Transaction Entry

- Application of the USGSGL at the Transaction Level. Transactions are processed following the definitions and defined uses of the general ledger accounts and standard general ledger account attributes as described in the USGSGL. Compliance with this standard requires that:
 - Reports displaying financial information that are produced by the system, whether used internally or externally, include financial data that can be traced directly to the USGSGL accounts.
 - The criteria (e.g., timing and processing rules or conditions) for recording financial events in all financial management systems are consistent with accounting transaction definitions and processing rules defined in the USGSGL.
 - Transaction details supporting USGSGL accounts are available in the financial management systems and directly traceable to specific USGSGL account codes.
- Federal Accounting Standards. Requires that accounting data be maintained in such a manner so as to permit reporting in accordance with government-wide accounting standards and reporting requirements issued by the OMB Director or the Secretary of the Treasury.
- Financial Reporting. Financial information shall be available in a timely and useful fashion that:
 - Supports management's fiduciary role.
 - Supports the legal, regulatory and other special management requirements of the agency.
 - Supports budget formulation and execution functions.
 - Supports fiscal management of program delivery and program decisionmaking.
 - Complies with internal and external reporting requirements.
 - Monitors the financial management system to ensure the integrity of financial data.
 - Captures and produces financial information required to measure program performance, financial performance, and financial management performance as needed to support port budgeting, program management and financial statement presentation.
- Budget Reporting. The system enables the preparation, execution and reporting on budgets in accordance with the requirements of OMB Circular A-11, "Preparation and Submission of Budget Estimates;" OMB Circular A-34, "Instructions on Budget Execution;" and other OMB-issued circulars and bulletins.

- Functional Requirements. The system conforms to the functional requirements defined in the Joint Financial Management Improvement Program (JFMIP) series of publications titled “Federal Financial Management Systems Requirements.”
- Computer Security Act Requirements. For those financial management systems that contain “sensitive information” as defined by the “Computer Security Act of 1987,” the system incorporates security controls in accordance with that Act and OMB Circular A-130.
- Documentation. Systems are documented clearly in paper or electronic medium in accordance with: (a) the requirements contained in the Federal Financial Management Systems Requirements documents published by the JFMIP, or (b) other applicable requirements.
- Internal Controls. Mechanisms are installed to safeguard against waste, loss, and misuse; and produce reliable reports. These system-related controls form a portion of the management control structure required by OMB Circular A-123.
- Training and User Support. Adequate training and appropriate user support is provided that enables the system users at all levels to understand, operate and maintain the system.
- Maintenance. The system operates in an effective and efficient manner. Periodic evaluations determine how effectively and efficiently each financial management system supports the agency’s changing business practices with appropriate modifications.

COMPLIANCE DETERMINATION

While the various policy issuances cited above offer a comprehensive set of directives, no government-wide instructions are yet available to guide federal agencies when making decisions as to whether their financial management systems comply with legislation, circulars and bulletins. While the OMB establishes financial management systems policies, other entities also have major roles in the financial management compliance review process. For example, the JFMIP publishes the “Federal Financial Management Systems Requirements;” audit organizations review financial management systems under FFMIA requirements; the Chief Financial Officers (CFO) Council and the Chief Information Officers Council oversee initiatives to improve systems and set appropriate standards; and the GAO oversees the audit of the consolidated financial statements for the federal government (which relies heavily on financial management systems). Coordination of these various groups is critical to the success of the financial management systems compliance review process.

The DFAS has produced “A Guide to Federal Requirements for Financial Management Systems” (“the Guide”). That issuance is an extensive compilation of requirements applicable to the Department’s financial management systems (finance, accounting, and feeder systems). The Guide contains numerous requirements promulgated by the OMB, the GAO, the Treasury Department, the JFMIP, and the Department of Defense. As such, this issuance is a valuable guide which can be used to assist systems managers in determining whether their systems

comply with federal financial management requirements. The Department intends to incorporate the requirements contained in the Guide into the “DoD Financial Management Regulation” (“DoDFMR”).

The Guide shall be used by managers responsible for finance, accounting and feeder systems and individuals performing finance, accounting or feeder systems reviews. These individuals include staff members and other managers responsible for finance, accounting, and feeder systems. The review of feeder systems covers those portions of the systems that originate or report financial data used by management for decisionmaking or financial reporting, or are provided to other financial systems.

The Guide shall be used as the primary tool to focus senior manager attention on the financial management requirements to be satisfied by their systems. Used as a tool within the Financial and Feeder Systems Compliance Process, the Guide’s compilation of federal financial systems requirements will support a standardization of DoD financial management and accounting operations and assure compliance with laws and regulations.

CONDUCT THE FINANCIAL MANAGEMENT SYSTEMS REVIEW

System compliance reviews shall be conducted to determine whether systems meet all applicable financial management requirements. A system is considered compliant if it meets all applicable detailed requirements contained in the Guide. The first step is to determine which requirements from the Guide are applicable to the system. System reviewers should:

- Select the chapter(s) that are applicable to the functions the system being evaluated was designed to perform. For example, the chapter on property, plant and equipment and the chapter on seized assets must be selected if the system is designed to perform both functions. These functions, however, may be performed by separate systems, each requiring evaluation.
- Select the functional requirements within each chapter that apply to the functions performed by the system being evaluated. (NOTE: Each chapter of the Guide contains a list of functional requirements and detailed requirements for each functional requirement.) All functional requirements in the applicable chapter must be performed in the system currently being evaluated or in another system subject to, and part of, the evaluation.
- Select applicable detailed requirements within each functional requirement category.
- Analyze the system’s operation against each applicable detailed requirement and determine the compliance status of the system for each requirement.
- Determine the compliance status of the system at the functional requirement level based on the compliance status of the system with the detailed requirements.

Each step shall be documented adequately and all documentation shall be retained for audit or management review. Upon the completion of each financial management and feeder system review, a summary of the review results shall be prepared. This summary should state whether

the system is (or is not) in compliance with financial systems requirements. Corrective action plans shall be developed for noncompliant systems. Corrective action plans shall include a discussion of the correction efforts needed in sufficient detail so that managers can understand the nature of the issues and the result desired when the corrections are completed. A corrective action plan shall identify the resources, remedies and target dates to resolve the identified issues:

- Resources--Estimated costs to be incurred to make the system compliant.
- Remedies--Specific steps/tasks necessary to fix the nonconforming system and parties responsible for taking such actions.
- Target Dates--The date when specific tasks identified in the plan will be completed.

For each corrective action plan, a corresponding funding plan shall be developed and approved by the Head of the applicable DoD Component.

Summary results of each review, together with a corrective action plan, shall be reported in the Department's "Financial Management Improvement Plan."

Systems (e.g., property accounting, inventory accounting, and personnel systems) often provide information to multiple business areas or reporting entities that are supported by multiple systems. For example, a property system may provide information to business areas in the Army General Fund as well as the Army Working Capital Fund. Each of these funds (i.e., reporting entities) may be supported by several systems whose detailed transactions must be traceable from the numbers recorded in the general ledger to their source in finance, accounting, or feeder systems. These systems must include appropriate internal controls in order for management to obtain accurate dollar values for property. Therefore, a business area or reporting entity cannot be compliant for property unless all of the systems supporting the function operate together as a compliant unit. Overall compliance at the business area and reporting entity levels, however, cannot be determined until all of the systems composing that business area and the reporting entity are compliant. Therefore, end-to-end integrated financial management systems tests shall be conducted following renovation of all systems for a business area and reporting entity. However, interim testing of interfaces between each of the applicable systems involved should be conducted as part of the renovation phase of the process.

A defined DoD reporting entity consists of one or more business areas. The DoD's financial reporting entities are identified in the "DoDFMR" and the Financial and Feeder Systems Compliance Process document. A reporting entity most often utilizes a number of finance, accounting, and feeder systems that, when operated in an integrated fashion, produce the entity's financial statements. Systems compliance shall be determined by business area and reporting entity to ensure the production of auditable financial statements. The end-to-end integrated financial management system test is similar to the tests performed on individual systems, but is done with the finance, accounting, and feeder systems working in concert. An end-to-end test shall not be performed on a business area or reporting entity until all of the finance, accounting, and feeder systems for that business area or entity have been renovated. However, interim testing of interfaces between each of the applicable systems involved should be conducted as part of the renovation phase of the process.

The OIG, DoD, Military Department audit agencies or independent public accounting/consulting firms shall perform the functional validations of the end-to-end tests. The DFAS, with assistance from the DoD Component responsible for the business area or reporting entity, shall initiate and oversee the end-to-end test. Such tests are necessary to ensure that financial data integrity is maintained and financial events are posted completely and consistently with applicable accounting principles and standards throughout the processing and reporting of data. The DFAS shall develop the methodology for conducting end-to-end tests and obtain approval from the Senior Financial Management Oversight Council before proceeding with the tests. If deficiencies are identified during the tests, the system(s) causing the deficiency shall be identified and then must restart the Financial and Feeder Systems Compliance Process at the Evaluation Phase. The DFAS shall maintain documentation that supports each end-to-end validation.